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Landmark Supreme Court verdict in the Vodafone case

Background

The Supreme Court of India (SC) has rendered its judgment in the much awaited verdict in the US \$ 2 billion Vodafone tax case [S.L.P. (C) No. 26529 of 2010]. In one of the most high profile cross border tax litigation involving taxability of a transaction between two non-resident companies (having no presence in India), in relation to transfer of shares of an overseas company, and after a period of four years involving two rounds of litigation at the High Court, and after hearing the matter over a period of two months, the SC has given a landmark decision in favour of Vodafone International BV, a Dutch company (VIH) to hold that the transaction is not taxable in India.

Facts

- The Hutchison Group (Hong Kong) had acquired interests in mobile telecommunications industry from 1992 onwards and over a long period of time, a large and complicated ownership structure¹ evolved. The Hutchison Group owned interest in the Indian operating company Hutchison Essar Ltd (HEL) – now known as Vodafone Essar Ltd. (VEL) through a number of overseas holding companies. HEL had further step down operating subsidiaries in India.

¹ For a detailed ownership structure on the date of the transaction, please refer page 29 of the order of the Court dated 20 January, 2012

- The majority of the share capital of HEL, which was under the direct or indirect control of Hutchison Group, was held by various Mauritius/Indian companies, which in turn were held by Mauritian/Cayman companies.
- Hutchison held certain call and put options (representing 15% of shareholding of HEL) over companies controlled by Asim Ghosh, Analjit Singh, etc. These options were in favour of 3Global Services Pvt. Ltd. (3GSPL), an Indian company, against consideration of credit support.
- In late 2006, Hutchison Telecommunications International Ltd., Cayman Islands (HTIL) received various offers from potential buyers to acquire its equity interest in HEL including Vodafone Group Plc, who made a non-binding offer for 67% of HEL for a sum of US\$ 11.076 billion, based on enterprise value of US\$ 18.8 billion of HEL.
- A sale purchase agreement dated 11 February 2007 (SPA) was entered into between VIH and HTIL for VIH to acquire the sole share of CGP Investment (Holdings) Ltd., a Cayman Islands company (CGP).
- Subsequently, on 20 February 2007 VIH filed an application under Press Note 1 of 2005 for an approval from Foreign Investment Promotion Board (FIPB) and for FIPB to make a noting of the transaction. Subsequently, on 7 May 2007, FIPB granted approval to VIH. On 8 May 2007, VIH paid over the consideration.
- VEL received a show cause notice dated 6 August, 2007 under section 163 of the Income-tax Act, 1961 (the Act) from the Revenue Authorities (RA) requiring to show cause as to why it should not be treated as a representative assessee of VIH which had failed to withhold tax under section 195 from payment made to HTIL. The notice was challenged by VEL in a writ petition before the Bombay High Court.
- Subsequently, VIH received a show cause notice dated 19 September, 2007 under section 201 from the RA to show cause as to why it should not be treated as an assessee-in-default for failure to withhold tax under section 195 from payment made to HTIL. The notice was challenged by VIH in a writ petition before the Court. The Court passed an order in December 2008 dismissing VIH's writ petition and affirming jurisdiction of the RA.
- VIH then filed a Special Leave Petition (SLP) before the SC. The SC, vide its order dated January 2009, held that VIH should submit the agreements with the RA, and the RA should then pass an order determining jurisdiction as a preliminary issue. The SC also held that the question of law to that extent shall remain open and VIH shall have a right to approach the Court directly in the event the RA assert jurisdiction.
- After a number of detailed hearings wherein enormous information and data was gathered from Vodafone, the RA passed an order dated 31 May 2010 asserting jurisdiction. This order was challenged by VIH before the Bombay High Court again, in terms of the SC order, by filing a writ petition.
- The Bombay High Court observed/held in September 2010 that
 - Alongwith the single share of CGP, other rights and entitlements, which constitute capital assets and 'property' were also transferred which was the real taxable event and VIH, by the diverse agreements that it entered into, has a significant nexus with Indian jurisdiction.
 - The essence of the transaction was a change in the controlling interest in HEL, which constituted a source of income in India.
 - The nature of the transaction has to be ascertained from the covenants of the contract and from the surrounding circumstances² and the subject

² National Cement Mines Industries Ltd. v. CIT. [1961] 42 ITR 69 (SC)

matter of the present transaction must be viewed from a commercial and realistic perspective.

- Chargeability and enforceability are distinct legal conceptions. A mere difficulty in compliance or in enforcement is not a ground to avoid observance.

Accordingly, the Bombay High Court held that in the present case, the transaction in question had a significant nexus with India.

- Against the order of the Bombay High Court, VIH filed an SLP before the SC. The SC, in the interim, directed VIH to deposit INR 25 billion with the SC and provide a bank guarantee for INR 85 billion, within three and eight weeks, respectively.
- Simultaneously, the RA issued a notice to VIH on 23 March 2011, initiating penalty proceedings for non-deduction of tax. VIH filed a SLP to stay the action of the RA. The SC on 15 April 2011 held that VIH should file its representation before the RA and no steps would be taken to enforce a penalty if imposed on the petitioner i.e. VIH.
- The SC heard the matter for over a period of two months and delivered the judgment on 20 January 2012.

Ruling of the Supreme Court

There are two judgments given in this matter. One is a majority judgment by Chief Justice of India S H Kapadia and Justice Swatanter Kumar and the other is a concurring judgment by Justice S Radhakrishnan.

Observations/decisions made in the majority judgment

Azadi Bachao Andolan v. McDowell and Co. Ltd.

RA's argument

Azadi Bachao Andolan³, a landmark SC judgment upholding the applicability of the India-Mauritius treaty, needs to be overruled insofar as it departs from McDowell and Co. Ltd.⁴ principle.

Majority decision

- The decision in the case of His Grace the Duke of Westminster⁵ and W.T. Ramsay Ltd.⁶ help us to understand the scope of Double Taxation Avoidance Agreement between India-Mauritius (Mauritius tax treaty).
- The issue raised by the RA in relation to McDowell and Co. Ltd. (above) is only in relation to tax avoidance/evasion and not on validity of the Circular(s) concerning Mauritius tax treaty.
- It is the task of the Court to ascertain the legal nature of the transaction and while doing so it has to look at the transaction as a whole and not to adopt a dissecting approach. In the present case, the RA have adopted a dissecting approach at the Tax officer level.
- The decision in McDowell & Co. Ltd. decision expresses the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colourable devices and by resorting to dubious methods and

³ UOI v. Azadi Bachao Andolan And Anr. [2003] 263 ITR 706 (SC)

⁴ McDowell And Company Ltd. v. CTO [1985] 3 SCC 230

⁵ Commissioners of Inland Revenue v. His Grace the Duke of Westminster [1935] All E.R. 259

⁶ W.T. Ramsay Ltd. v. IRC [1981] 1 All E.R. 865

subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible.

- Reading McDowell, in the manner indicated, in cases of treaty shopping and/or tax avoidance, there is no conflict between the decisions in McDowell & Co. Ltd. (above) and Azadi Bachao Andolan (above) or between McDowell & Co. Ltd. (above) and Mathuram Agrawal⁷.

Concurring decision/observations by Jc K. S. Radhakrishnan

- RA cannot tax a subject without a statute to support and every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury. RA's argument that the ratio laid down in McDowell & Co. Ltd. (above) is contrary to what has been laid down in Azadi Bachao Andolan (above), in view of the SC, is unsustainable and, therefore, calls for no reconsideration by a larger Bench of the SC.

International tax aspects of holding structures

Majority decision

- The approach of both the corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on the **separate entity principle**, i.e., treat a company as a separate person.
- The fact that a parent company exercises shareholder's influence on its subsidiaries does not generally imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. Further a parent company's executive director(s) should lead the group and the company's

shareholder's influence will generally be employed to that end. This obviously implies a restriction on the autonomy of the subsidiary's executive directors which is the inevitable consequence of any group structure, is generally accepted, both in corporate and tax laws.

- Whether a transaction is used principally as a colourable device for the distribution of earnings, profits and gains, is determined by a review of all the facts and circumstances surrounding the transaction.
- The SC has given certain examples to explain when the principle of lifting the corporate veil or the doctrine of substance over form or the concept of beneficial ownership or the concept of alter ego arises.
- It is a common practice in international law, which is the basis of international taxation, for foreign investors to invest in Indian companies through an interposed foreign holding or operating company, such as Cayman Islands or Mauritius based company for both tax and business purposes. Special Purpose Vehicles (SPVs) and Holding Companies have a place in legal structures in India, be it in company law, takeover code under Securities Exchange Board of India (SEBI) or even under the Income tax law.
- The SC further observed that in this case they were not concerned with treaty shopping but with the anti-avoidance rules or General Anti-Avoidance Rule (GAAR). The concept of GAAR is not new to India since India already has a judicial anti-avoidance rule, like some other jurisdictions. In the application of a judicial anti-avoidance rule, the RA may invoke the 'substance over form' principle or 'piercing the corporate veil' test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the impugned transaction is a sham or tax avoidant.
- The RA cannot start with the question as to whether the impugned transaction is a tax deferment/saving device but that it should apply the 'look at' test to

⁷ Mathuram Agrawal v. State Of Madhya Pradesh [1999] 8 SCC 667

ascertain its true legal nature. Every strategic foreign direct investment (FDI) coming to India, as an investment destination, should be seen in a holistic manner keeping in mind the following factors

- the concept of participation in investment,
 - the duration of time during which the holding structure exists;
 - the period of business operations in India;
 - the generation of taxable revenues in India;
 - the timing of the exit;
 - the continuity of business on such exit.
- The onus will be on the RA to identify the scheme and its dominant purpose and discarding an interposed holding company has to be done by RA at the threshold.
 - The corporate business purpose of a transaction is evidence of the fact that the impugned transaction is not undertaken as a colourable or artificial device. The stronger the evidence of a device, the stronger the corporate business purpose must exist to overcome the evidence of a device.

Concurring decision/observations by Jc K. S. Radhakrishnan

- One of the tests to examine the genuineness of the structure is the 'timing test' that is timing of the incorporation of the entities or transfer of shares etc. Structures created for genuine business reasons are those which are generally created or acquired at the time when investment is made, at the time when further investments are being made, at the time of consolidation, etc. CGP was

incorporated in the year 1998 and the same became part of the Hutchison corporate structure in the year 2005.

Whether section 9 of the Act is a 'look through' provision

RA's argument

If primary argument fails, that under the SPA, HTIL has directly extinguished its property rights in HEL and its subsidiaries, in any event, income from the sale of CGP share would nonetheless be covered by section 9 of the Act since it provides for a 'look through'.

Majority decision

The SC held that they find no merit in the submissions of RA that section 9 provides for 'look through' for the following reasons –

- Section 9(1)(i) of the Act consists of three elements, namely, transfer, existence of a capital asset, and situation of such asset in India, which should exist in order to make the capital asset taxable.
- Section 9(1)(i) of the Act cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situate in India. To do so, would amount to rewriting/changing the content/ambit of section 9(1)(i) of the Act and would render the express words 'capital asset situate in India' nugatory. Thus, the expression 'directly or indirectly' contained in section 9(1)(i) of the Act go with the income and not with the transfer of a capital asset (property). Similarly, the expression 'underlying asset' do not find place in section 9(1)(i) of the Act. Further, the Direct Taxes Code Bill, 2010 (DTC) proposes taxation of indirect transfer of a capital asset, which in a way indicates that indirect transfers are not covered by section 9(1)(i) of the Act.

- The question of providing 'look through' or 'Limitation of Benefit' in the statute or in the tax treaty is a matter of policy and has to be expressly provided for in the statute/tax treaty and cannot be read into by interpretation.

Concurring decision/observations by Jc K. S. Radhakrishnan

- Source in relation to an income has been construed to be where the transaction of sale takes place and not where the item of value, which was the subject of the transaction, was acquired or derived from. Hence, applying this principal in the present transaction, the source of income is outside India, unless legislation ropes in such transactions. Further, expression used in section 9(1)(i) of the Act is 'source of income in India' which implies that income arises from that source and there is no question of income arising indirectly from a source in India.
- Wherever the legislature wanted to tax income which arises indirectly from the assets, the same has been specifically provided so. On a comparison of section 64 (that has the expression 'directly and indirectly' appear twice, once with the income part and then again with the expression 'transfer') and section 9(1)(i) of the Act (which does not contain such an association with the word 'transfer'), what is discernible is that the legislature has not chosen to extend section 9(1)(i) of the Act to 'indirect transfers'.

Transfer of HTIL's property rights by extinguishment

RA's argument

HTIL had under the SPA, directly extinguished its rights of control and management, which are property rights over HEL and its subsidiaries and, consequent upon such extinguishment, *de hors* of the CGP shares, there was a transfer of capital asset situated in India.

Majority decision

- We are concerned with the sale of shares and not with the sale of assets, item-wise.
- We need to apply the 'look at' test, according to which, the task of RA is to ascertain the legal nature of the transaction and, while doing so, it has to look at the entire transaction holistically and not to adopt a dissecting approach.
- In a case like the present one, where the structure has existed for a considerable length of time generating taxable revenue right from 1994 and where the Court is satisfied that the transaction satisfies all the parameters of 'participation in investment', then in such a case, the Court need not go into the questions such as *de facto* control *v.* legal control, legal rights *v.* practical rights, etc. Thus, it cannot be said that the Hutchison structure was created or used as a sham or tax avoidant. If one applies the look at test discussed hereinabove, without invoking the dissecting approach, then, in our view, extinguishment took place because of the transfer of the CGP share and not by virtue of various clauses of SPA.
- In this case, we are concerned with the expression 'capital asset' in the income tax law. Applying the test of enforceability, influence/persuasion cannot be construed as a right in the legal sense. The concept of '*de facto*' control, which existed in the Hutchison structure, conveys a state of being in control without any legal right to such state. This aspect is important while construing the expression 'capital asset' under the Income tax law.
- There is a conceptual difference between a preordained transaction which is created for tax avoidance purposes, on the one hand, and a transaction which evidences investment to participate in India. In our view, on the facts and circumstances of this case, the right of HTIL, if at all it is a right, to direct a downstream subsidiary as to the manner in which it should vote would fall in

the category of a persuasive position/influence rather than having a power over the subsidiary.

- Under the HTIL structure, as it existed in 1994, HTIL occupied only a persuasive position/influence over the downstream companies *qua* manner of voting, nomination of directors and management rights. Further, the minority shareholders/investors had participative and protective rights (including right of first refusal (RoFR)/tag along rights (TARs), call and put options which provided for exit) which flowed from the CGP share. The entire investment was sold to VIH through the investment vehicle (CGP). Consequently, there was no extinguishment of rights as alleged by RA.

Concurring decision/observations by Jc K. S. Radhakrishnan

- Controlling interest: Controlling interest might have percolated down the line to the operating companies but that controlling interest is inherently contractual and not a property right unless otherwise provided for in the statute. Controlling interest, which stood transferred to Vodafone from HTIL accompany the CGP share and cannot be dissected so as to be treated as transfer of controlling interest of Mauritian entities and then that of Indian entities and ultimately that of HEL/VEL.
- Debts/loans through intermediaries: All loan agreements and assignments of loans took place outside India at face value and, hence, there is no question of transfer of any capital assets out of those transactions in India, attracting capital gains tax.
- Non-compete agreement: An agreement for a non-compete clause was executed offshore and, by no principle of law, can be termed as 'property' so as to come within the meaning of capital gains taxable in India in the absence of any legislation.

- Hutch Brand: Under the SPA, the license for using the Hutch brand was given and it was expressly made free of charge and, therefore, the assurance given by HTIL to Vodafone that the brand name would not cease overnight, cannot be described as 'property' right so as to consider it as a capital asset chargeable to tax in India.

Role of CGP in the transaction

RA's argument

CGP stood inserted at a later stage in the transaction in order to bring in a tax-free entity (or to create a transaction to avoid tax) and thereby avoid capital gains. Further, since CGP was merely a holding company and could not conduct business in Cayman Islands, the *situs* of the CGP share existed where the 'underlying assets are situated', that is, India.

Majority Decision

- CGP was incorporated in 1998 in Cayman Islands. It was in the Hutchison structure from 1998. The transaction in the present case was of divestment and, therefore, the transaction of sale was structured at an appropriate tier, so that the buyer really acquired the same degree of control as was hitherto exercised by HTIL. VIH agreed to acquire companies and the companies it acquired controlled 67% interest in HEL. CGP was an investment vehicle.
- Two routes were available, namely, the CGP route and the Mauritius route. It was open to the parties to opt for any one of the two routes. However, the Mauritius route was available but it was not opted for because that route would not have brought in the control over 3GSPL.
- The sole purpose of CGP was not only to hold shares in subsidiary companies but also to enable a smooth transition of business, which is the basis of the

SPA. Therefore, it cannot be said that the intervened entity (CGP) had no business or commercial purpose.

- Under the Indian Companies Act, 1956, the *situs* of the shares would be where the company is incorporated and where its shares can be transferred. In the present case, it has been asserted by VIH that the transfer of the CGP share was recorded in the Cayman Islands, where the register of members of the CGP is maintained. This assertion has neither been rebutted in the impugned order of the tax department dated 31 May, 2010 nor traversed in the pleadings filed by the RA nor controverted before us. In the circumstances, we are not inclined to accept the arguments of the RA that the *situs* of the CGP share was situated in the place (India) where the underlying assets stood situated.

VIH acquire 67% controlling interest in HEL and not 42%/52%

RA's Argument

VIH had acquired 67% interest in HEL and not 42%/52%, as sought to be propounded by it.

Majority Decision

- The expression 'control' is a mixed question of law and fact. The basic argument of the RA is based on the equation of 'equity interest' with the word 'control'. On the basis of the shareholding test and the facts, HTIL could be said to have a 52% control over HEL and had no control over balance 15% stake in HEL as suggested even by the FIPB approval.
- Pending exercise, options providing 15% shareholding in HEL are not management rights and at best be treated as potential shares and till exercised they cannot provide right to vote or management or control.

- As regards the question as to why VIH should pay consideration to HTIL based on an enterprise value of 67% of the share capital of HEL is concerned, it is important to note that valuation cannot be the basis of taxation. The basis of taxation is profits or income or receipt. In this case, enterprise value is made up of two parts, namely, the value of HEL, the value of CGP and the companies between CGP and HEL. In the present case, the RA cannot invoke section 9 of the Act on the value of the underlying assets or consequence of acquiring a share of CGP.
- The facts indicate that the object of the SPA was to continue the 'practice' concerning nomination of directors on the Board of Directors of HEL which in law is different from a right or power to control and manage and which practice was given to keep the business going, post acquisition. Under the company law, the management control vests in the Board of Directors and not with the shareholders of the company. Therefore, neither from the shareholders agreement nor from the term sheet, one could say that VIH had acquired 67% controlling interest in HEL. The difference between the 52% figure (control) and 67% (equity interest) arose on account of the difference in computation under the Indian and US GAAP.

Acquisition of CGP share with 'other rights and entitlements' – as held by Bombay High Court

RA's contention

As held by the Bombay High Court, applying the 'nature and character of the transaction' test, VIH acquired the CGP share with other rights and entitlements which constituted in themselves 'capital assets' within the meaning of section 2(14) of the Act.

Majority Decision

- The subject matter of the transaction has to be viewed in this case from a commercial and realistic perspective. Applying the principles governing shares and the rights of the shareholders to the facts of this case, we find that this case concerns a straight forward share sale. The tax consequences of a share sale would be different from the tax consequences of an asset sale.
- On examination of the impugned judgment, we find a serious error committed by the High Court in appreciating the case of VIH before FIPB. 67% of the economic value of HEL is not 67% of the equity capital. If VIH would have acquired 67% of the equity capital, as held by the High Court, the entire investment would have had breached the FDI norms which had imposed a sectoral cap of 74%.
- The High Court ought to have applied the look at test in which the entire Hutchison structure, as it existed, ought to have been looked at holistically. When one applies the 'nature and character of the transaction test', confusion arises if a dissecting approach of examining each individual asset is adopted.
- The High Court has failed to examine the nature of the following items, namely, non-compete agreement, control premium, call and put options, consultancy support, customer base, brand licences, etc. On facts, we are of the view that the High Court, in the present case, ought to have examined the entire transaction holistically.
- A controlling interest is an incident of ownership of shares in a company, something which flows out of the holding of shares. A controlling interest is, therefore, not an identifiable or distinct capital asset independent of the holding of shares. The control of a company resides in the voting power of its shareholders and shares represent an interest of a shareholder which is made up of various rights contained in the contract embedded in the Articles of

Association. The right of a shareholder may assume the character of a controlling interest where the extent of the shareholding enables the shareholder to control the management. Shares, and the rights which emanate from them, flow together and cannot be dissected.

- The parties to the transaction have not agreed upon a separate price for the CGP share and for what the High Court calls as 'other rights and entitlements' (including options, right to non-compete, control premium, customer base etc.). Thus, it was not open to the RA to split the payment and consider a part of such payments for each of the above items.

Concurring decision/observations by Jc K. S. Radhakrishnan

- Controlling interest does not depend upon the extent to which they had the power of controlling votes. The principle that emerges is that where shares in large numbers are transferred, which result in shifting of 'controlling interest', it cannot be considered as two separate transactions namely transfer of shares and transfer of controlling interest. Controlling interest forms an inalienable part of the share itself and the same cannot be traded separately unless otherwise provided by the statute. Controlling interest is inherently contractual right and not property right and cannot be considered as transfer of property and hence a capital asset unless the statute stipulates otherwise⁸.

Scope and applicability of sections 195 and 163 of Act

Majority decision

- If in law the responsibility for payment is on a non-resident, the fact that the payment was made, under the instructions of the non-resident, to its

⁸ IRC v. Bibby & Sons [1946] 14 ITR (Supp) 7

agent/nominee in India or its permanent establishment (PE)/branch office will not absolve the payer of his liability under section 195 of the Act to deduct tax.

- The investment made by Vodafone Group companies in Bharti did not make all entities of that Group subject to the provisions of the Act and to the jurisdiction of the tax authorities. Since VIH did not have any tax presence in India vis-à-vis the overseas transaction, this does not bring VIH under the jurisdiction of the Indian tax authorities. Further, since the RA failed to establish any connection with section 9(1)(i) of the Act, the withholding tax provisions under section 195 of the Act would not apply to VIH.
- On the facts of this case, section 163(1)(c) of the Act – dealing with treating VIH as a representative assessee of HTIL – is not attracted as there is no transfer of a capital asset situated in India, and consequently, VIH cannot be proceeded against even under section 163 of the Act as a representative assessee.

Concurring decision/observations by Jc K. S. Radhakrishnan

Whether the presumption of territoriality holds good as far as section 195 of the Act is concerned and is there any reason to depart from that presumption.

- A literal construction of the words ‘any person responsible for paying’ under section 195 of the Act to include non-residents would lead to absurd consequences. A reading of various sections such as 191A, 194B, 194C, 194D, 194E, 194I, 194J read with sections 115BBA, 194I, etc. would show that the intention of the Parliament was first to apply section 195 of the Act only to the residents who have tax presence in India.
- The expression ‘any person’, in SC’s view, by looking at the context in which section 195 of the Act has been placed, would mean any person who is a resident in India. This view is also supported, if we look at similar situations in other countries, when tax was sought to be imposed on non-residents.

- Section 195 of the Act, would apply only if payment is made from a resident to a non-resident and not between two non-residents where both are situated outside India. In the present case, the transaction was between two non-resident entities through a contract executed outside India and the consideration was also passed outside India. In the view of the SC, the ruling in the case of *Eli Lilly and Company (India) P. Ltd.*⁹ is of no assistance to the facts of the present case, as in that case the services were rendered in India and also received a portion of their salary from JV situated in India.
- That transaction has no nexus with the underlying assets in India. In order to establish a nexus, the legal nature of the transaction has to be examined and not the indirect transfer of rights and entitlements in India.

India-Mauritius tax treaty

Decision/observations by Jc K. S. Radhakrishnan

- On the controversy surrounding the India–Mauritius tax treaty, the SC held that in light of i) the fact that the treaty does not have limitation of benefit (LOB) clause, ii) presence of Circular No. 789 issued by the Central Board of Direct Taxes, and iii) existence of the tax residency certificate (TRC) issued by the Mauritian authorities, the RA cannot at the time of sale, deny treaty benefits on the reasoning that the FDI was only ‘routed’ through a Mauritius company.
- The SC also observed, however, that it would not preclude the RA from denying the tax treaty benefits, if it is established, on facts, that the Mauritius company has been interposed as the owner of the shares in India, at the time of disposal of the shares to a third party, solely with a view to avoid tax without any commercial substance.

⁹ CIT v. Eli Lilly and Company (India) Pvt. Ltd. (2009) 15 SCC 1

- The TRC, though can be accepted as a conclusive evidence for accepting status of residents as well as for beneficial ownership so as to apply the tax treaty, it can be ignored if the treaty is abused for the fraudulent purpose of evasion of tax.
- Round Tripping involves getting the money out of India, say Mauritius, and then invest back the money into India in the form of FDI or Foreign Institutional Investment. In such cases, the TRC defence would be denied if it is established that such an investment is black money or capital that is hidden, it is nothing but circular movement of capital known as round tripping, since the transaction is fraudulent and against national interest.

Conclusion of the SC by majority

Majority decision

- Applying the 'look at' test in order to ascertain the true nature and character of the transaction, it was held that the offshore transaction herein is a *bona fide* structured FDI into India which fell outside India's territorial tax jurisdiction, hence not taxable.
- The offshore transaction evidences participative investment and not a sham or tax avoidant preordained transaction.
- The subject matter of the offshore transaction was the transfer of share of CGP, a company incorporated in Cayman Islands, and consequently, the RA had no territorial tax jurisdiction to tax such an offshore transaction.
- Certainty in enactment of laws, and stability, form the basic foundation of any fiscal system and how tax policy certainty is crucial for taxpayers (including foreign investors) to make rational economic choices in the most efficient manner and helps the tax administration in enforcing the provisions of the taxing laws.

- The RA is hereby directed to return the sum of INR 25 billion, which came to be deposited by the appellant in terms of the SC's interim order, with interest at 4% per annum within two months. Further, the SC has directed to release the bank guarantee of INR 85 billion as well.

Decision/observations by Jc K. S. Radhakrishnan

- It is difficult to agree with the conclusions arrived by the Bombay High Court that the sale of CGP share by Hutchison to Vodafone would amount to transfer of a capital asset within the meaning of section 2(14) of the Act. It is also difficult to agree with the conclusion of the Bombay High Court that the rights and entitlements flow from framework agreements, shareholders agreements, term sheet, loan assignments, brand license etc., which form integral part of CGP share attracting capital gains tax.
- Consequently, the tax demand of nearly INR 120 billion by way of capital gains tax, would amount to imposing capital punishment for capital investment, since it lacks authority of law and, therefore, stands quashed.
- Jc K. S. Radhakrishnan also stated that he concurs with all the other directions given in the judgment delivered by the Lord Chief Justice (i.e. by the majority).

Concluding remarks

- The Vodafone controversy, which had created a lot of uncertainty for multinationals having similar structures and/or which had entered into or were proposing to enter into similar transactions, and thus, this should provide the much needed respite to these litigants. However, given that the Finance Budget is around the corner and also given that the DTC proposes to tax similar transactions, one would need to wait and see what would be the recommendations of the 10-member committee, which is set up by the Central Board of Direct Taxes post the aforesaid SC judgment to evaluate the Vodafone judgement.

- However, any conclusions in this regard in each individual case can only be reached based on the fine print analysis of the judgement and applying the same in the context of the peculiar facts of each case. Further, the DTC contains a proposal to tax similar transactions; hence, this ruling may have limited relevance post implementation of the present form of the DTC.
- Having said the above, the SC judgment does send positive signals to the global investing community that India is indeed a top destination for investment and provides the much needed certainty around deals/M&A activity in the otherwise lackluster market. On the one hand, the judgement settles the controversy that was pending for long, at the same time it boosts confidence of the investor in the Indian judiciary that the judiciary would ultimately uphold the law and not be swayed by other considerations.

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Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	Bangalore 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	Bhubaneswar IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296	Chennai PwC Center, 2nd Floor 32, Khader Nawaz Khan Road Nungambakkam Chennai 600 006 Phone +91-44 4228 5000	Hyderabad #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600
Kolkata South City Pinnacle, 4th Floor, Plot – XI/1, Block EP, Sector V Salt Lake Electronic Complex Bidhan Nagar Kolkata 700 091 Phone +91-33 4404 6000 / 44048225	Mumbai PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	Gurgaon Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	Pune GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, pwctrs.knowledgemanagement@in.pwc.com

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